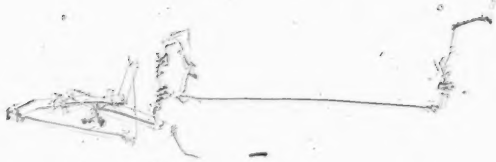

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940
No. 601.

PAUL W. SAMPSELL, Trustee in Bankruptcy for the Estate of WILBUR J. DOWNEY, also known as W. J. DOWNEY,
Petitioner,

vs.

IMPERIAL PAPER AND COLOR CORPORATION,
Respondent.

REPLY TO PETITION AND BRIEF FOR CERTIORARI.

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REPLY TO PETITION AND BRIEF FOR CERTIORARI.

Doubtless it is superfluous, in view of their complete lack of any substance or merit, to make any reply to the petition and brief herein filed. Nevertheless, to render all possible assistance to the Court in making its way through the maze that this application creates, and to repel any possible inference of acquiescence or assent to any of the claims petitioner advances, respondent respectfully offers the following considerations. Emphasis is supplied unless otherwise credited.

Alleged Grounds of the Petition.

To justify itself under Rule 38, 5, (b), of the Rules of this Court, the petition ("First," p. 3) asserts there is involved "a question of *far-reaching importance*"; and also, that there is "*conflict*," with decisions of another Circuit, and, with some decisions of this Court.

For specification, the petition ("Second", pp. 3-4) poses three questions, which are *assumed* to arise on, what is *further assumed* to be, "the record."

In this connection, it is respectfully suggested it is necessary to note that the "Transcript of Record" brought here is in three parts: 1, the record of the *proceedings reviewed* by the Circuit Court, filed in said court on January 17, 1940 [Tr. 1-72]; 2, the matters contemplated by the "*leave* to appellee (*May 1*, 1940) *to file* a certified copy of *order* of referee in bankruptcy of *April 7, 1939*, and pleadings on which order was based, *Mr. Casey objecting* thereto," which copy was *filed May 2, 1940* [Tr. 75-117]; and 3, "a *supplemental record*," to include "(1) Schedules A and B * * * by Wilbur J. Downey, bankrupt * * *"; "(2) all proofs of debts or proofs of claim filed by creditors of said bankrupt * * *"; and "(3) the inventory * * * filed by the trustee," which record was filed by *order* of the Circuit Court [Tr. 118-198].

It is further necessary to note that the opinion of the Circuit Court [Tr. 201, note 1] specifically finds that "the record on appeal consists" of the records filed *January 14*, 1940, and *July 12*, 1940. Thus, the objection of respon-

dent's attorney, "Mr. Casey," above noted, is sustained. And properly so. In the record reviewed by the Court, it appears [Tr. 21] that the *referee* affirmatively certified the respondent here "was *not a party*" to the proceeding in which the *"alter ego"* order of April 7, 1939, was entered. Thereby, as the Circuit Court holds [Tr. 209], that proceeding, and that order, could never bind this respondent, or operate as *res adjudicata* of any of its rights. (*Willis v. Lauridson,* 161 Cal. 106, 117, quoting *Mallow v. Hinde,* 25 U. S. 193, 198, 6 L. Ed. 499.)

Nor, in the proceedings reviewed by the Circuit Court, did the petitioner here seek to litigate any such issues with respondent. There, as the record shows [Tr. 19], his sole grounds of objection were: "I," that respondent could not claim "within *Sections 64-c or (b)* of the Bankruptcy Act"; and "II," that respondent's claim was on "open account and *wholly unsecured,*" and "does *not* claim a *lien* on the *assets* of said *bankrupt estate.*" Nothing of any fraudulent transactions whatsoever is in anywise even suggested or intimated. It is not even denied that respondent's dealings with the corporation, Downey Wall Paper and Paint Co., were in perfect good faith, at all times, as respondent's petition in said proceedings specifically avers they were. [Tr. 15.] While respondent did not claim any lien on *"assets* of said *bankrupt estate,"* it did specifically claim an "equitable lien" on the *proceeds* of assets which the trustee (petitioner here) had taken from the respondent's *debtor, the corporation.* [Tr. 16, "IV"].

The questions proposed in the petition (pp. 3-4), above mentioned, relate to the following: "1," the respondent's right to any *lien*, and the *satisfaction* thereof, under the facts of this case; "2," Section 64 of the Bankruptcy Act; and "3," Assumed hardships, under the Circuit Court's decision, of a trustee who seeks to recover a bankrupt's assets which have been fraudulently conveyed.

It is submitted that throughout, but particularly in the announcement of these "questions," the petition, in respects most material, does not truly reflect the facts in the record, but relies wholly upon *assumptions* which are contrary thereto. Thus, in "1," it is *assumed* that:

Respondent (Imperial Co.) *"participated"* in the "bankrupt's (Downey's) *fraud*," and *"fraudulent transfer"* to the "fraudulent transferee" (Downey Co.);

Respondent's petition and claim were "against the *bankrupt estate*";

Respondent claimed it was "entitled to *priority*," in that *estate*;

In respondent's petition and claim, there was *"absence* of any *lien*, equitable or otherwise."

In number "2" (p. 4), the petition carries forward the *assumption* that respondent claimed *"priority classification* as to assets which have become *part* of the *bankrupt estate."*

In number "3" (p. 4), it is *assumed* that the *respondent* is to be *bound* by anything in the proceedings leading to the *"alter ego" order* of *April 7, 1939.*

The Facts in the Record.

The petition (pp. 4-12) purports to state the facts of "the proceedings had in the courts below." It is submitted that this statement is so far partial and forced, and at the same time so interlarded with references to the immaterial matters pertaining to the *"alter ego"* order of April 7, 1939, as not to be helpful at all. It is further submitted that the statement by the Circuit Court, marked as it is by meticulously careful reference to "chapter and verse" of the record for support, is much more complete and useful.

It is apparently the theory of the petition that its recital of facts shows a fraudulent transfer by the bankrupt Downey in *1936* to an *alter ego* corporation, in which transaction the respondent *participated,* and that the trustee in *Downey's* bankruptcy,—which was initiated in the fall of *1938,*—by his proceeding, culminating in the *"alter ego"* order of April 7, 1939, had *recovered,* as a *part* of the *bankrupt estate,* the assets *then* held by the corporation, to the exclusion of all rights of respondent, which had dealt with the corporation meanwhile. No such theory is sustainable upon this record.

The fundamental error in such theory is the *assumption* that respondent claimed as a creditor of the *bankrupt,* or of his bankrupt estate, and against any *part* of that estate. Instead, respondent is, and always has been, a creditor of the *corporation;* and claims, and has claimed, against *proceeds* of the property of the *corporation,* of which property the trustee (petitioner here) had possessed himself, and then sold.

The next false note is a reliance upon the *"alter ego"* order of April 7, 1939, which has nothing to do with this case. Not only so, but there is also involved the erroneous assumption that the *"alter ego"* order *destroyed*, or could destroy, the *corporate entity* and obliterate all transactions theretofore had with it by third persons.

It is forced and false, to state that respondent *"instigated,"* or *"participated,"* in anything fraudulent. All the pertinent record disproves it. The evidence received on the hearing in the proceeding reviewed is in the record. [Tr. 39-66.] It there particularly appears that respondent had nothing to do with any *transfer* of assets to the Downey corporation, and did not know about anything such, until after it was all arranged for. [Tr. 43, 44, 50-51, 52-53.] Respondent was not even interested that the corporation should have any assets. [Tr. 43, 44.] The fundamental, outstanding facts in the record in this regard are these: respondent demanded that a corporate entity be formed, before it would enter into any dealings; such entity was formed, and thereafter, respondent dealt with it exclusively, and extensively [Tr. 60-61]; these dealings continued from *1936* to *1938*, and at the end, the corporation still owed the respondent the amount of its present claim, for property delivered to and still in the corporation's hands, and taken from it by the trustee and then sold [Tr. 61]; and at the time this was done, respondent was the corporation's *sole creditor*. [Tr. 35, 61.] The assets, business and accounts of the corporation were at all times

kept separate and apart from those of the individual, Downey. [Tr. 60.]

The petitioner here nowhere denies that the Standard Co., at all times, had full knowledge of the sale to the corporation in *1936*. Such a denial, in any event, would not be competent, in view of the record made [Tr. 56] of the notice required by California statute (Civil Code, Sec. 3440). Such is the purpose of the statute. Neither is it denied, since its own statement of its claim shows it [Tr. 181], that, in the interval between *1936* and *1938*, the Standard Co. received more than $20,000.00, together with interest, on its old account, and also, in *1938*, did new business with Wilbur J. Downey which, after all credits, left a new claim of over $4,000.00, at the time of Downey's bankruptcy. [Tr. 132-136.] Neither is it said that Standard Co., Downey's *only* creditor in *1936* [Tr. 54], ever made any objection or complaint, until after September, *1938*. Meanwhile, respondent had had all its dealings with the *corporation;* and the latter had long since sold and disposed of all property it had received from Downey in the sale in 1936. [Tr. 61.]

Ingeniously, the petitioner's statement (pp. 5, 7) attempts to insinuate into the record the existence of "a promissory note," in the amount of "$14,000.00," or "$14,194.72." No record is pointed to where any such note is exhibited; or where such is stated to have existence, the theory is worked out through references to an "inventory," or "inventoried," "value," of "$14,000.00," or "$14,-194.72" (p. 7). This is done apparently to create ground

for a contention that the trustee might have a claim against the corporation. Primarily, there is, of course, no necessary connection between the *value* of property, and the *amount paid* for it in a sale. But, in any event, the theory is dissipated by the record facts, to wit: the recorded notice of the sale fixed the amount of the note at *$7,500.00* [Tr. 56]; in the proceeding presented here, the referee found that *respondent* "is the *only* creditor of Downey Wallpaper & Paint Co." [Tr. 35]; no such note is inventoried in the Downey estate [Tr. 124]; and it appears that Downey owed the *corporation*. [Tr. 122, 136.]

This theory of the petition is met and exploded by the Circuit Court's opinion [Tr. 205-206].

Petitioner's Alleged Grounds for Reversal.

The petition (p. 12) states two reasons for reversal, to-wit: 1, "the opinion is based on numerous *erroneous* conceptions of fact, *undisputed*", relative to the transactions affecting the Standard Co.; and 2, the opinion "creates a *new class of creditors* not provided for in Section 64-a or b of the Bankruptcy Act" in conflict with two cited decisions of the Eighth Circuit, and also, "would impose an *onerous burden* on trustees" seeking to act under "Sections 67-d and e, and Section 70-e of the Bankruptcy Act",—which *latter* theory, it should be said, is *not* raised in petitioner's objections before the referee [Tr. 19],—all in conflict with two decisions of this Court which require *"equality* of distribution of *bankrupt assets"*.

Respondent's Positions.

The whole petition is based upon two false premises. namely: 1, that respondent is, or ever was, a *creditor* of Downey, the *individual bankrupt,* claiming against *such* bankrupt estate, instead of being, as it has always insisted it was, a *creditor* of the *corporation,* claiming an *equitable lien* on the *proceeds* of property of the *corporation* which the trustee has improvidently and wrongfully taken from the corporation and sold; and 2, that the *"alter ego" order* of April 7, 1939, has any bearing on this case,—other than to show the *genesis* of the wrongful taking by the trustee,—and particularly, that such order could serve to *destroy the corporate entity,* and also destroy the legal status of all transactions theretofore had by that entity with third persons, acting in the usual course of business.

In addition, the petition relies upon the *false assumption* that respondent was any party to any *fraud;* if any, practiced by the individual, Downey, as against the Standard Co., in *1936.*

By reason, at least, of these false elements, the petition is wholly without basis or merit, and its prayer should be denied. The decision of the Circuit Court is sound, and fully justified, in fact and in law, and should not be disturbed.

Concerning the Petitioner's Brief.

In view of the matters hereinbefore noted, the various points in the brief may each be shortly dealt with. *It is strikingly noticeable, that petitioner does not even mention, much less meet, the rulings of the Court on "alter ego", and the cases cited* [Tr. 208-210].

The Alleged Conflicts.

First is brought forward (pp. 17-24) the contentions that the present decision is "in conflict" with two decisions of the Eighth Circuit, and two of this Court. Relying on his theory, already noted, that respondent is a creditor of the bankrupt Downey, and is claiming against his bankrupt estate, petitioner brings forward, *in extenso,* Section 64-b of the Bankruptcy Act, and also several other sections which he says govern the relations between a trustee and a bankrupt and that bankrupt's assets, and cites (pp. 17-18), *Southern Bell T. & T. Co. v. Caldwell,* 67 Fed. (2d) 802, *United States F. & G. Co. v. Sweeney,* 80 Fed. (2d) 235,—both from the Eighth Circuit,— and *Moore v. Bay,* 284 U. S. 4, and *Buffum v. Barcelóux Co.,* 289 U. S. 227. Inasmuch as respondent is *not* claiming as any creditor of the bankrupt, and is seeking nothing against any bankrupt estate, the foregoing statutes and decisions are not in point, so far as they relate to any matters of rights between creditors of a bankrupt estate, and such decisions can raise no "conflict" with the present decision.

Relying on his theories, that the *"alter ego"* order of April 7, 1939,—the basis of which he did not bring forward in the original proceedings [Tr. 19],—can apply to this case, that it operated as a recovery of "property of the bankrupt" *transferred* in 1936 *"in fraud* of creditors", and that respondent "instigated" and "participated" in such transactions, petitioner also brings forward Section 70-e of the Bankruptcy Act,—which he did not mention on the original proceedings [Tr. 19],—and cites (p. 21) two other cases which he says require "an *equal basis"* (emphasis respondent's) in the distribution of *bankrupt*

estates. Since respondent was guilty of no fraud, and, as to it, the *"alter ego"* order settled nothing, the citations last mentioned are not in point, and it is not claimed they create any "conflict". It thus appears that the wealth of words expended on petitioner's contentions here vanishes in nothingness. It abundantly appears that respondent's claim is that of an *equitable lien* upon the *proceeds* of property of a non-bankrupt *corporation*, with which respondent has dealt exclusively, for at least two years. Remington on Bankruptcy, Section 2857.70, makes the necessary distinction very clearly, when the author says:

> "* * * though there *may be* an *'equitable lien'*, there can be *no equitable priority.*"

A word should be said on one of the cases cited. Petitioner is not familiar with *United States F. & G. Co. v. Sweeney, supra.* What he must rely on was merely *direction* to the lower court, in the event of new trial (p. 240 (15)). What he did not note is, that the *decision reversed* a judgment which *denied* an *equitable lien* under circumstances in essence equivalent to the instant case, the Court saying (p. 239 (6, 7, 8)):

> *"Equitable liens,* if created before the four months period preceding bankruptcy, are *valid* and enforceable *against the trustee"*, etc.; and "* * * its (the surety company's) rights had their *inception* at the time it became surety for the construction company."

There, the surety company paid for labor and materials of a contractor, and was reimbursed out of funds belonging to the contractor, who had become bankrupt. It was the *trustee's judgment recovering* the reimbursement which was *reversed.* Here, the inception of the respondent's

rights long antedated any bankruptcy. It had been dealing continuously with the corporation for at least two years.

Respondent's right to the equitable lien claimed is made clear by the following cases, *Hurley v. Atchison, etc. Co.*, 213 U. S. 126, 132-133, 53 L. Ed. 729, 733; *Carroll v. Stern*, 223 Fed. 723, 724; *In re Alleman Hdw. Co.*, 158 Fed. 119, 120-121.

The last two cases are factually parallel with the instant case, and, in each, the right of the *corporation's* creditor to a lien, a right to first payment, was sustained.

Hurley v. Atchison, etc., Co., supra, at pages 132-133 (733), sustains the power of a bankruptcy court to recognize and enforce such a lien. Nothing in *Burton Coal Co. v. Franklin Coal Co.*, 67 Fed. (2d) 796, cited in the brief (p. 17), is in conflict therewith, or with the instant decision recognizing the respondent's right independent of any right of the bankrupt estate.

Petitioner says little about an *equitable lien,*—except (p. 22) that such is, "on personal property in California, absolutely impossible"; and he cites 16 *Cal. Jur.*, "Liens", *Section 12,* p. 310, and Section 3440 of the California Civil Code,—which latter, by its own terms, relates only to *legal* liens. Petitioner should have read *Section 10,* p. 307, of his authority on "Liens", instead of Section 12. Section 10 states:

> "*In equity* a *lien* consists in the *right* to subject the property, *even though not in the possession of the lienor,* to the payment of the *debtor or claim,* as a *charge of the property.*"

Petitioner's Claim of the Court's "Misconception" of Fact.

Petitioner (pp. 25-39) develops an argument with the opinion of the Circuit Court, as to what the record shows. Inasmuch as this argument is based upon that part of the transcript [pp. 76-117] which contains the proceedings which led to the *"alter ego"* order of April 7, 1939, any such discussion is fruitless, and time and space will not be wasted thereon. Since respondent was no party to those proceedings, it could not be bound thereby, and no part of them was or could be considered as evidence affecting the respondent's rights. For this reason, obviously, the Court disregarded them. It may be noted that no part of the petitioner's argument is directed against the contents of the Downey Schedules, and proofs of debt, which the Circuit Court ordered to be added to the record, as a supplement.

It is scarcely accurate to say that any of these things came before the Court "without the benefit of oral argument" (p. 25). They were all argued extensively, at the hearing on May 1, 1940 [Tr. 75]. Thereby, came the "leave" to the petitioner "to file" the matters he desired [Tr. 75], which were filed the next day [Tr. 87, 117], and which the Court ultimately found objectionable, and disregarded. From the same argument derived also the Court's order for the "supplemental record".

One statement of petitioner (p. 39) will be noticed. He complains that "no effort was made * * * to establish an equitable lien on the stock in trade of the Downey Wallpaper & Paint Co." No formal effort was necessary under the circumstances. The trustee had taken the "stock in trade" and sold it. All creditors of the corporation,

other than respondent, had been paid [Tr. 61]. Necessarily then, respondent's claim and rights would rest as a charge upon all the corporation's assets, until it could be determined whether all, or what part, might be required to pay the amount of the respondent's debt. (16 *Cal. Jur.*, "Liens", Section 10, p. 307.)

Petitioner's Claim of Rights by Statute.

Relying on his theory that there was a fraudulent transfer in *1936,* which respondent "instigated", and in which it "participated", petitioner quotes Section 3439 of the California Civil Code (p. 40), and, as his next point (pp. 40-47), contends that the Circuit Court fell into error, because it "apparently overlooked the fact that there were other creditors of the bankrupt", etc. (p. 41). Not creditors of the vintage of *1936,* however, but of current character [Tr. 128-178]. Irrespective of the unsoundness of the theory of respondent's connection with any fraud, if any, it is petitioner who "overlooked" something; not the Court. Petitioner overlooks the fact that the sale here was made under the "bulk sales law" (California Civil Code, Section 3440), as such was in effect at the times petitioner mentions. Petitioner further ignores the facts, that the required notice was duly given [Tr. 56]; that possession by the vendee was taken and maintained, separate and apart, as was the corporation's business with respondent [Tr. 60], until petitioner himself took the corporation's assets [Tr. 61]. The Court did

not overlook Section 3440, but expressly referred to it [Tr. 204]. Section 3439 is not referred to, because it can have no application against respondent upon the facts of this case. Section 3440 provided, in pertinent parts:

> "Provided, also, that the sale * * * of a stock in trade, in bulk, or a substantial part thereof * * * will be conclusively presumed to be fraudulent and void as against the *existing* creditors of the vendor * * * unless * * * the vendor shall record * * * a notice of said intended sale," etc.

Such a limitation of creditors' rights to attack is essential in such cases, to prevent just such a periling of the contracts and rights of subsequent dealers with the vendee as the petitioner is contending for here.

Petitioner and "Alter Ego."

In his last point (pp. 48-50), petitioner marshals once more all his theories, but adds one more. He asserts (p. 48) that, because respondent in its petition in this proceeding *"affirmatively alleged"* that the "bankrupt estate and the trustee thereof *claims and asserts"* the corporation "is and was the *alter ego*", etc., and "the trustee did not dispute *that fact,"* "therefore, a *retrial* of the issue of *Downey's fraudulent intent* was unnecessary." Petitioner has before suggested this theory as an excuse for not establishing, *as against respondent,* what it now *claims is fact.* (Pet. p. 11; Br. p. 46.)

It is submitted that any such theory is but lame and labored. In the first place, what "fact" is it, that respondent thus "affirmed and alleged"? Manifestly, it is no more than that the trustee had made such a claim and

assertion. It certainly was no admission of the *validity* of the thing claimed and asserted. Much less was it an admission of the facts necessary to be established, before *respondent* would be affected thereby. The proof of this lies in the very filing of its claim and petition for an equitable lien, superior to all other rights. The real reason for the allegation, and its only valid effect, is to disclose why the proceedings were brought against the trustee. Since, by virtue of the *"alter ego"* order which he had obtained, without affording respondent an opportunity to present its own rights, the trustee had seized the corporation's property and sold it, respondent's only proper relief was by the method adopted. But his pleading must show why it was that the remedy was resorted to. The allegation petitioner seizes upon can mean no more. Petitioner's attempt to explain his non-action, fails to explain. Still less does it explain why he did not deny the direct and positive allegation of respondent's "good faith" appearing in its petition [Tr. 15, "II"].

Conclusion.

In conclusion, it is respectfully submitted, that the petition herein is without merit, and should be denied; and that the judgment of the Circuit Court is in all things justified, both in fact and in law, and should not be disturbed.

Respectfully submitted,

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